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Directive 01-9: Offset of a Corporation's Recapture Tax against its Current Year Tax Credits

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Background:

General Laws, chapter 63 requires a recapture tax with respect to three tax credits where property generating a credit is disposed of before the end of its useful life. These credits are (1) the investment tax credit (ITC) available under c. 63, Â§ 31A; (2) the economic opportunity area credit (EOAC) available under c. 63, Â§ 38N; and (3) the Brownfields credit available under c. 63, Â§ 38Q. For example, if a corporation disposes of a qualifying Â§ 31A asset before its useful life has been exhausted, the corporation is required to "add back as additional taxes due in the year of disposition" (i.e., recapture) "the difference between the credit taken and the credit allowed for actual use." G.L. c. 63, Â§ 31A(e). Similar treatment is accorded to the other two credits. See G.L. c. 63, Â§Â§ 38N(a) and 38Q(b). For purposes of this directive, the phrase "recapture tax" will refer to the excess of the credit taken to offset the corporate excise in any tax year over that allowed for actual use.

Historically, the Department interpreted the above sections to preclude a corporation from offsetting the recapture tax with either credits generated during the year of the property's disposal or credits carried over from previous years. This Directive sets out a new interpretation of these sections that allows the combination of any recapture tax with the excise due under G.L. c. 63, Â§Â§ 32 or 39 before 1) the application of carryover and current year credits, and 2) the application of the 50% limitation required by G.L. c. 63, Â§ 32C.

Issue 1: Can a corporation apply its carryover and current year tax credits against an amount equal to i) the recapture tax plus ii) the excise due under G.L. c. 63, Â§Â§ 32 or 39 for the current year?

Directive 1: A corporation can apply its carryover and current year tax credits against an amount equal to i) the recapture tax plus ii) the excise due under G.L. c. 63, Â§Â§ 32 or 39 for the current year to the extent otherwise permitted under chapter 63.

Issue 2: Can a corporation's recapture tax be included as part of "the excise imposed by section thirty-two and thirty-nine [of chapter 63]" for purposes of calculating the 50% limitation that is applied to a corporation's credits under G.L. c. 63, Â§ 32C?

Directive 2: The amount of a corporation's recapture tax will be considered part of the excise imposed by G.L. c. 63, Â§Â§ 32 and 39 for purposes of calculating the 50% limitation that applies to a corporation's credits under G.L. c. 63, Â§ 32C.

Discussion:

Under G.L. c. 63, Â§ 31A(e), ITC recapture is "added back as additional taxes due in the year of disposition." (emphasis supplied). Whether the additional taxes that result from a recapture of the ITC constitute part of the corporate excise or a separate "tax" is an issue of statutory construction in which the "word[s] used [are] not decisive[;] ... [t]he real character of the monetary exaction is the

ultimate factor. *See Eaton, Crane & Pike Co. v. Commonwealth*, 237 Mass. 523, 528 (1921)(war bonus "tax" construed to be an excise and not a property tax in light of the system of corporate taxation established for many years in the Commonwealth).

ITC recapture operates to reduce the amount of ITC a corporation has previously taken to reflect the corporation's actual use of the qualified property that generated the ITC. In other words, ITC recapture is a re-imposition of a corporation's excise from a prior year because that corporation is no longer entitled to claim the full amount of ITC taken in that prior year. Hence, while ITC recapture is labeled as an "additional tax" by c. 63, Â§ 31A(e), it is in substance an excise originally calculated under G.L. c. 63, Â§Â§ 32 or 39 (i.e., the corporate excise). The recapture tax is a component part of the corporate excise, just as the income and non-income measures of the corporate excise are component parts. Since the statutory language requiring recapture of the EOAC and the Brownfields credit is essentially the same as that pertaining to the ITC, it follows that any portion of the EOAC or Brownfields credit that is recaptured is, in substance, also part of the corporate excise. *See* G.L. c. 63, Â§ 38N(a); G.L. c. 63, Â§ 38Q(b).[\(1\)](#)

Once the recapture of a credit is classified as a component of a corporation's excise, the above directives follow. Under the structure of chapter 63, unused credits that may be carried over from year to year are added to current year credits and are applied against the excise, *see e.g.*, G.L. c. 63, Â§Â§ 31A, 31C, 31E, 31F, 31H. Using credits that will expire first, *see* Directive 88-23, the combination of credits will generally reduce the excise by a maximum of 50% of the excise, but not below \$456. G.L. c. 63, Â§ 32C. Available credits which cannot be used in the current tax year may be carried forward to other years if they qualify for carryover status under G.L. c. 63, Â§Â§ 31A(g), 32C, 38N(d) or 38Q(f). However, any credits which could not be used because credits cannot reduce the corporate excise by more than 50% may be carried forward indefinitely under G.L. Â§ 32C.[\(2\)](#) *See* Directive 88-24 for a more detailed discussion of the carry forward rules.

This Directive applies to all open tax years. Taxpayers may apply for an abatement starting with the first open tax year that generated a recapture tax.

Directive 1 Examples

Example 1: Corporation A generates \$10,000 of ITC in 1999 for property with a useful life of five years. It uses \$5,000 of this ITC to reduce its excise before disposing of the property 24 months after purchase. Corporation A has an ITC carryover of \$5,000 attributable to this property. The amount of ITC recaptured is \$6,000 ($36/60 \times \$10,000$), \$ 5,000 of which is used to offset the ITC carryover attributable to the property. Corporation A's recapture tax of \$1,000 is added to its corporate excise before credits.

Example 2: In July of 2000, Corporation B purchases three properties: property 1, property 2 and property 3. Each property purchased has a useful life of five years; each property purchased generates an ITC of \$10,000. Corporation B uses \$10,000 of its ITC on its 2000 return and carries over the remaining \$ 20,000 of the ITC. For each property, one third, or \$3,333, of the ITC is used and two-thirds, or \$6,667, of the ITC is carried over. After 12 months, Corporation B disposes of property 1. The amount of ITC recaptured is \$8,000 ($48/60 \times \$10,000$), \$6,667 of which is used to offset the ITC carryover that relates to property 1. Corporation B's recapture tax of \$1,333 is added to its corporate excise before credits.

Directive 2 Examples

Example 1: On its 2001 return, Corporation C's corporate excise before credits is \$7,000. During 2001, Corporation C purchased property that generated an ITC of \$12,000. Corporation C has \$3,000 of ITC generated from property purchased in 2000 that it could carry forward for three years. Corporation C did not dispose of any property during 2001 that would require recapture of the ITC, the EOAC or the Brownfields credit.

In offsetting its corporate excise by the available ITC, Corporation C can not use more than \$3,500 ($50\% \times \$7,000$) in credits on account of the 50% limitation under G.L. c. 63, Â§ 32C. Corporation C first uses the \$3,000 of ITC it has carried over from 2000, leaving an excise of \$4,000. Corporation C may further reduce its excise by using only \$500 of the current year ITC since this amount of credit brings it to the 50% limit. Corporation C has an ITC carryover of \$11,500, \$3,500 of which can be carried forward indefinitely on account of the 50% limitation and \$8,000 of which can be carried over for three years.

Example 2: On its 2001 return, Corporation D's corporate excise before credits is \$7,000 (\$2,000 of which resulted from recapture tax). During 2001, Corporation D purchased property that generated an ITC of \$12,000. Corporation D has \$3,000 of ITC generated from property purchased in 2000 (which it still owns) that it could carry forward for three years. Corporation D's qualified research expenses in 2001 generated a \$5,000 research credit.

In offsetting its corporate excise by the available credits, Corporation D cannot use more than \$3,500 (50% x \$7,000) in ITC on account of the 50% limitation under G.L. c. 63, Â§ 32C. The 50% limitation, however, is not applicable to the research credit. Corporation D first uses the \$3,000 of ITC it has carried over from 2000, leaving an excise of \$4,000. Corporation D may further reduce its excise by using only \$500 of the current year ITC since this amount of credit brings it to the 50% limit. Corporation D has an ITC carryover of \$11,500, \$3,500 of which can be carried forward indefinitely on account of the 50% limitation and \$8,000 of which can be carried over for three years. Corporation D can then reduce its excise to the minimum excise of \$456 by applying \$3,044 of the research credit. The remaining \$1,956 of research credit can be carried forward for 15 years.

Example 3: On its 2001 return, Corporation E's corporate excise before credits is \$70,000 (\$20,000 of which resulted from recapture tax). During 2001, Corporation E purchased property that generated an EOAC of \$40,000. In 2001, Corporation E's qualified research expenses generated a \$50,000 research credit.

In offsetting its corporate excise by the available credits, Corporation E cannot use more than \$35,000 (50% x \$70,000) in EOAC on account of the 50% limitation under G.L. c. 63, Â§ 32C. The 50% limitation, however, is not applicable to the research credit. Corporation E can reduce its \$70,000 excise before credits by \$35,000 of EOAC because of the 50% limitation, resulting in an excise of \$35,000 and an EOAC unlimited carryover of \$5,000. Corporation E can then use \$34,544 of research credit to reduce its excise to the minimum excise of \$456. The remaining \$15,456 of research credit can be carried over for 15 years.

/s/ Bernard F. Crowley, Jr.,
Bernard F. Crowley, Jr., Acting
Commissioner of Revenue

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Footnotes:

1. The Department requires taxpayers to first reduce any recaptured credits by any credit carryover balance attributable to the property that had generated the credit in determining the amount of the recapture tax. See Directive 89-7, Example 3. For other Departmental statements on this topic, see 830 CMR 63.38N.1 ("Economic Opportunity Area Credit"); TIR 99-13 ("The Tax Credit Provisions of the Brownfields Act"), and TIR 00-9 ("Tax Changes Related to the Fiscal Year 2001 Budget"). ([return to text](#))

2. Note that the research credit at G.L. c. 63, Â§ 38M is not subject to the 50% limitation. 830 CMR 63.38M.1(8)(d). See *also* 830 CMR 63.38M.1(9) for how the research credit interacts with other credits. (Where a corporation is eligible for both the research credit and a credit that is limited by M.G.L. c. 63, Â§ 32C, . . . In determining the amount of corporate excise liability for purposes of

applying the limitations on any credits, such amount need not be adjusted to reflect the amount of any other credit claimed, provided, however, that no credit may be used to reduce the corporate excise below the minimum corporate excise.) ([return to text](#))